U 2030-1

HARVARD

RRC NEWSLETTER

RUSSIAN RESEARCH CENTER

Vol. VI, No. 3

November 12, 1981

PRODUCTION FIGURES FOR THE FIRST 9 MONTHS OF 1981

Product	Jan.-Sept.81	% of 1st 9 mos. of 81 over 80
Electricity (bil. kw. hrs)	969.0	102.0
Petroleum (incl. gas condensate, mil. tons)	455.0	101.0
Natural Gas (bil.cu.m.)	342.0	107.0
Coal (mil. tons)	528.0	98.0
Steel (mil.tons)	112.0	101.0
Metal-Cutting Tools (mil.rubles)	1544.0	105.0
Computer Tech. (bil.rubles)	3.7	113.0
Television Sets (mils.)	6.1	108.0
Color T.V.s	2.0	120.0
Paper (mil.tons)	4.1	102.0
Watches (mils.)	51.3	104.0
Cement (mil.tons)	4.1	102.0
Meat (mil. tons)	6.8	101.0
Margerine (1000 tns)	980.0	106.0
Motor Vehicles (1000s)		
cars	985.0	99.3
trucks	581.0	99.0
Tractors (1000s)	416.0	100.5
Fertilizer (mil. tons)	19.8	105.0

PROBLEMS IN THE PETROLEUM INDUSTRY

The industrial production figures for the first nine months of 1981 show the same generally disappointing trends that have been reported for the last several months. The September results, however, show one new wrinkle. While petroleum production for the whole nine months increased at 1% above what had been produced in the first nine months of 1980, the September 1981 figures compared to the September 1980 figures indicate a more serious problem. Production in 1981 apparently just equalled production in September 1980. In other words, this is the first time in years, and probably the first time since this Newsletter appeared, that petroleum production did not increase over what it had been in the month of the preceding year. The Soviets still have a chance of meeting their planned production goal for all of 1981, but if production for the remainder of the year does not increase, they are likely to fall just short of their target. If production is the same in October, November, and December 1981, as it was in October, November, and December 1980, that would mean the Soviets can look forward to producing approximately 153.6 million tons of petroleum. Added to what they have already reported as of this Newsletter, that would leave them with total production of about 609 million tons. That would mean that they would fall short of the plan for 1981 by about 1 million tons; certainly not a significant shortfall, but nonetheless a drop below what they had planned. More importantly, however, if they now find themselves unable to increase production over the levels of last year, that would mean that production would indeed level off in 1982, and might even drop a bit. It remains to be seen whether or not production would drop substantially. The CIA apparently thinks that it will because its recent estimates indicate that production should fall to 500-550 million tons by 1985. That would mean a drop of over 50-100 million tons a year. That still seems unlikely, but it may well be the case that Soviet production may indeed have reached its peak.

There is another possible explanation for the somewhat lower production levels reported. The Soviet newspaper, Sotsialitcheskaya Industria published an article on October 4, 1981 indicating that one of their deputy ministers had been guilty of misusing important technology. More

importantly, in an effort to disguise and obscure the misuse of this technology, he allegedly over-reported production figures in the fields for which he was responsible. These more sober results may reflect a re-adjustment for that purpose.

As for production of other goods, the downturn continues. Whereas last year at this time, electricity production was growing at 5% a year, now it is only growing at 2%. Only in the gas industry do figures remain at a high level.

BALANCE OF TRADE FIGURES

In our November Newsletter of 1980, we were able to report to you the balance of trade figures for the first half of 1980. Normally those first half-year figures are available at this time. Unfortunately, the Soviets have apparently not released them, according to their regular schedule. That may be an indication that their trade balance has continued to deteriorate as we reported for the first quarter of the year. If and when more recent figures are available, we shall include them in future issues of the Newsletter.

SENATOR CRANSTON TO SPEAK AT ARDEN HOUSE

The program for the Arden House Conference is gradually taking shape. We are pleased that Senator Alan K. Cranston, Democrat from California, will join us at Arden House this year. He recently returned from the Soviet Union, and has agreed to share his views on current developments in the Soviet Union and his views on prospects for American-Soviet relations. In addition, Ambassador Arthur Hartman, currently in Moscow, expects to join us for the first evening session on Friday, March 5th. He will be back in the country for home leave, and will join us there, as will, we hope, several other of our former Ambassadors. We have also heard from Dr. F. Wilhelm Christians, a member of the Board of Managing Directors of the Deutsche Bank in Dusseldorf, who will also join us to participate in a panel discussion on the Yamburg Natural Gas Pipeline.

The program is not yet complete, but we expect to have other sessions just as interesting. Application forms for the conference should be sent out before the end of the year or the beginning of January 1982. Remember, however, that the conference will be held March 5-7, 1982, which is a bit earlier than normal.

CORPORATE SPONSOR SEMINAR SERIES FOCUSES AGAIN ON EASTERN EUROPE

Since we didn't solve the East European problem last year, we have decided to hold another session on Eastern Europe as part of our Corporate Sponsor Series. The program will meet in Cambridge on February 8, 1982. A copy of the program and application blank are enclosed with this Newsletter.

CURRENCY FIGURES

Rubles Purchased Per 100:	Oct.80	Sept.81	Oct.81
Austrian shilling	5.060	4.340	4.580
U.K. pound	154.570	137.830	131.800
W. German mark	35.790	30.340	32.100
U.S. dollar	64.400	75.000	71.300
French franc	15.410	12.670	12.780
Japanese yen	.301	.326	.311
Italian lira	.0753	.0610	.0603
Swiss franc	39.130	34.940	38.000

The currency exchange rates as published by Gosbank for October 1981 show that the Austrian shilling, German mark, French franc, and Swiss franc increased in value during the month. All other currencies reported here dropped in value.

The Russian Research Center takes no official stand on any economic or political matter. The views and analyses expressed in this Newsletter are those of the authors directly associated with the article in question; and, unless otherwise stated, with those of the editor, Marshall I. Goldman.

© Russian Research Center 1981

BEST AVAILABLE COPY

The Boston Globe
Sunday, November 8, 1981

EASTERN EUROPE

Polish economic disease spreads

Debts to West, Soviet refusal to guarantee them, a Communist bloc syndrome

Net hard currency debt to the West

Millions of dollars

Country	'71	'72	'73	'74	'75	'76	'77	'78	'79	'80
Bulgaria	723	909	997	1360	2257	2756	3169	3710	3730	3000
Czechoslovakia	160	176	273	640	827	1434	2121	2513	3070	3300
E. Germany	1205	1229	1876	2592	3548	5047	6159	7548	8440	9700
Hungary	848	1055	1096	1537	2195	2852	4491	6532	7320	7100
Poland	764	1150	2213	4120	7381	10680	13532	16972	20000	24500
Romania	1227	1204	1495	2483	2449	2528	3388	4992	6700	8600

Source: CIA

By Marshall I. Goldman

Economic conditions in Poland have deteriorated to such a state that some economists now conclude there may be no happy and cost-free solution. Moreover, there are signs that the Polish economic disease is so infectious that it has already spread to other countries in Eastern Europe.

Oddly enough, there is reason to believe that the collapse of the Polish economy was not inevitable. While there is no doubt that the selection of a Polish pope and a resurgence of Polish nationalism served to mobilize the population, these two factors alone would not have been enough to bring about the uprooting of the Polish political system and the accompanying collapse of the economy. Equally important as a cause of the problem was the Polish government's decision to seek outside help in revitalizing the Polish economy. Unfortunately, the medicine adopted instead of curing has all but crippled the patient.

Western aid part of Gierek strategy

The decision to turn to the West for help was made after December 1970 when Edward Gierek replaced Wladslaw Gomulka as head of the Polish Communist Party. The change in leadership was precipitated by worker protests over food price increases just before the Christmas holidays. Gierek realized that the only way he could escape a replay of what had happened to Gomulka was if he could bring about a relatively rapid improvement in Polish economic conditions. Realizing that the East European and Soviet technology which Poland had been using until that point had become obsolete and was not up to the standards of the outside world, Gierek decided to turn instead to the West. In this way, he hoped he would usher in a new world of material prosperity that would finally satisfy Polish workers and consumers. At the time, Gierek's idea was widely applauded. These new factories would not only improve Polish living conditions, but by exporting some of their products, these factories would pay for themselves. Moreover, because of the continuing worldwide inflation, the loans which would be used to buy most of these factories would be paid back in inflated currencies. In theory then, the whole exercise would be relatively costless.

Gierek's strategy was a radical departure from Gomulka's approach. Gomulka relied primarily on machinery from within Poland itself or elsewhere in the Communist bloc. The magnitude of Gierek's switch can be gauged by a look at the accompanying table. Gomulka left Gierek with one of the lowest levels of net hard currency debt in Eastern Europe; only Czechoslovakia and Bulgaria had a lower debt prior to 1971. But as Gierek's orders for new machinery began to flow into Western markets, the debt mounted rapidly. Beginning in 1971, it all but doubled

year to year so that by 1973 the Polish debt exceeded that of all the other East European states and by 1975 made up over 40 percent of the total debt of all the East European countries. From 1971 to 1980, Poland imported over $13 billion worth of new machinery and equipment.

While he had little trouble in fulfilling the import part of his strategy, Gierek found he could not implement the export half of the equation. If all had gone according to plan, by the mid-1970s Poland's new factories should have been exporting their way out of debt. That was not to be. As attractive as the idea of bringing in Western technology might have been, Poland, after years of operating under the shadow of the Soviet economic model, found it was not equipped to absorb and master this Western technology. Moreover, the new factories were poorly chosen and construction and operations were not completed as planned. Consequently, instead of generating increased export earnings, these new factories actually increased import costs and hard currency debt. A surprisingly large percentage of the new factories were designed to use imported raw materials. Consequently, by the mid-1970s, more and more of Poland's foreign loans were needed to pay for imports of raw materials, and repayment of interest and principal on the existing debt. Moreover, because of its increasing debt, Poland was forced to borrow its money at fluctuating and not fixed interest rates. Thus, instead of making it easier to repay its debt, inflation and the accompanying high interest rates made it more costly for Poland to pay its debt. By 1977, the debt had already become unmanageable and, despite the willingness of Western bankers to throw in good money after bad, it was only a question of time before there would be an economic collapse.

A domino effect in Eastern Europe?

The crippling consequences of Gierek's import policy were not limited to the industrial sector. The overemphasis on foreign industrial technology resulted in the increased neglect of the country's agricultural needs. Resources were drained from agriculture in order to pay for machinery imports and farmers were encouraged to go to work in industry. After a time, agricultural production suffered. Bad weather compounded the problem.

Inevitably the shortcomings in industry and agriculture had an impact on worker morale. What was the sense of working when there was nothing to buy for the money they earned? This in turn set the stage for the birth of the first large-scale independent trade union in a Communist country.

While the events in Poland are fascinating in and of themselves, they are also of immense consequence for Poland's neighbors. We used to speak of the domino effect in Southeast Asia. But today it is probably even more meaningful in Eastern Europe. For example, the Polish economic disease seems to have spread to Romania, accelerated in part by what happened in Poland. It is now clear that the Soviet Union will not guarantee Polish debt. The bankers assumed that the Soviets would guarantee their East European friends' debt under a protective umbrella. In the storm that has developed, the bankers have discovered that there is no umbrella – it is more like a leaky rain hat. Given that unpleasant discovery, Western bankers are now taking a harder look at their loans to some of the other East European countries where the loans for equipment have proven to be almost as nonproductive. Thus, loans have been cancelled in Romania and the Romanians have found it necessary to postpone their debt repayments. This has cut off the flow of some imports and forced the Romanians to search for additional products to export, including food, which in turn has led to food rationing. This in turn has set off unrest. The troubles in Romania added to those in Poland naturally have caused foreign lenders to look askance at their loans elsewhere in Eastern Europe, including even Hungary, perhaps the most sophisticated of all the East European countries; and in East Germany. Thus, what begins as external pressure quickly becomes converted into internal pressure, which sets off demands for more consumer and worker rights.

The contagion from what has happened in Poland spreads in other ways as well. For example, the breakdown in Polish production means that manufacturers elsewhere in Eastern Europe and the Soviet Union are not receiving the supplies, including coal, that they expect and need from Poland. That causes even more disruption throughout the bloc.

In many ways the collapse of economies in the bloc triggers a sense of panic that is like a run on the bank. The East Europeans need foreign credits if they are to revitalize their economies. Yet their basic economic systems under the Soviet model are so unresponsive that when advanced technology from the outside is grafted onto the outmoded system, it is not efficiently utilized. This even happens in Hungary. Nonetheless, the bills accumulate. As this realization spreads, more and more foreign lenders will start to recall their loans. But when they all recall at once, there will be nothing left. By 1977, it was probably already too late to stop the slide of Poland into bankruptcy, and so it may be too late today to rescue Romania. And the more countries in Eastern Europe that have trouble, the more likely the others will suffer the same fate. There are some who wonder how long the Soviet Union itself can avoid similar problems.

Marshall I. Goldman is professor of economics at Wellesley College and associate director of the Russian Research Center, Harvard University. He is completing a book on the obstacles to economic reform in the Soviet Union.